

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Longville Analyst: Kristina E. North Bill Number: AB 190
Related Bills: See Legislative History Telephone: 845-6978 Amended Date: April 26, 2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Campaign Financing Reform Act of 2002/Legislative Election Fund

SUMMARY

This bill would:

- Allow individuals to make contributions of income tax liability to the Legislative Election Fund (LEF); and
- Create the Campaign Financing Reform Act of 2002 (the Act).

This analysis addresses only those provisions that impact the Franchise Tax Board (FTB).

SUMMARY OF AMENDMENTS

The April 26, 2001, amendments added provisions to establish the LEF and create the Act.

As introduced February 7, 2001, this would repeal the Government Code section prohibiting public officers from expending and candidates accepting public moneys for the purpose of seeking elective office.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author, this bill would provide public financing for state legislative elections to decrease candidate dependence on donations from special interests.

EFFECTIVE/OPERATIVE DATE

This bill specifies that the LEF would be effective January 1, 2002, and first appear on the **1999** tax return. (See first technical consideration below.) The other provisions of this bill would become effective March 5, 2002, if approved by the voters at the statewide primary election. If the voters reject the other provisions, the LEF also would become inoperative. If voters approve the other provisions, the Act allowing expenditure of public money for campaign elections would become operative on or after July 1, 2002, if the Controller determines that the amount of money collected in the LEF is \$20 million or more.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

06/18/01

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to work with author's staff to resolve the concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAWS

Current federal tax law provides a true check-off to direct \$3 (\$6 for married individuals filing jointly) of a taxpayer's tax liability to the Presidential Election Fund. Designation of the \$3 amount does not affect a taxpayer's tax liability or refund amount. **Current state law** does not allow taxpayers to designate any portion of their tax liability to an election campaign fund.

Current state tax law allows taxpayers to make contributions of their own funds (not tax liability) on their tax returns to the 13 voluntary contribution funds listed on the state tax return. Each fund provides for the reimbursement of the FTB's and the State Controller's actual costs to administer the fund.

Except for the California Senior's Special Fund, which has no sunset date, the voluntary contribution funds have various sunset dates. Attachment I shows the specific sunset dates for each voluntary contribution fund and indicates that all funds except for the California Senior's Special Fund must meet a minimum contribution test (as indexed, if required) to remain on the return. Attachment II is a chart indicating the number and dollar amount of contributions to the funds for multiple fiscal years.

Under the Political Reform Act of 1974, **current state law** requires the FTB to audit political committees, lobbyists, lobbyist employers, and political candidates, including those campaigning for the Legislature, constitutional, or local government offices. Generally, 25% of candidates whose contributions exceed established amounts are audited on a random sample basis. If contributions are less than \$15,000, a 10% random sample audit is required for Supreme Court, Courts of Appeal, and Board of Equalization candidates.

THIS BILL

The provisions of this bill would not take effect unless the voters approve the Act in March 2002.

This bill would establish the LEF to be administered by the Controller, allowing individual taxpayers to designate an amount up to \$5 or up to \$5 each for married individuals filing jointly. The designation must be made in full dollar amounts of **tax liability** to the fund. This contribution would not change the tax owed or the refund due to a taxpayer. Under the Government Code, this fund would provide funding to match contributions to eligible nominees, as defined, and funding of all administrative costs associated with this chapter. This bill specifies that the fund would be continuously appropriated.

Individuals with a tax liability of \$5 or more, or a married couple with a liability of \$10 or more, would be allowed to designate a deposit to the LEF. Tax liability would be defined as the amount of taxes imposed, minus all credits except the Renter's Credit, withholding credit, excess tax credit, and estimated taxes.

This bill would require FTB to revise all original personal income tax forms (which include the Form 540, Form 540EZ, Telefile, Form 541, Form 540NR, and scannable forms) for the **1999** tax year and thereafter to include the LEF designation. Specifically, this bill would require that, on the first page immediately preceding the filing status, language be included to allow each individual taxpayer to designate \$5 of tax liability to the LEF.

This bill also would require that tax returns specify that the designation would not increase a taxpayer's tax liability or reduce any refund.

This bill would require FTB to notify the Controller of the amount of money designated "*as the tax returns are received* by [FTB] from the taxpayers."

This bill would require reimbursement of costs incurred in connection with FTB's and the Controller's duties.

IMPLEMENTATION CONSIDERATIONS

Section 5 of this bill specifies that the LEF designation would become operative for returns filed for taxable years beginning in 2001. However, Section 8 provides that the LEF would become inoperative if the voters do not approve the public campaign financing provisions in the statewide direct primary election to be held on March 5, 2002. Tax returns with the required LEF designation would be available to taxpayers by late 2001. In the event that voters reject the campaign election provisions, it is unclear what date the author intends the LEF to become inoperative and what treatment the author intends for any LEF designations made on 2001 returns filed prior to March 5, 2002.

This bill has an internal conflict. It specifies that individual taxpayers may designate "**up to** five dollars" (\$1, \$2, \$3, \$4, or \$5) to the LEF; however, it would require that the tax return only allow a single amount, "five dollars," to be designated to the LEF. If the author's intent is to allow the taxpayer to designate a single amount, like the Presidential Election Fund on the federal tax return, the author may wish to consider deleting the phrase "up to." Clarification this issue is necessary to avoid confusion between taxpayers and the department.

This bill would require FTB to notify the Controller of money designated to the LEF "*as the income tax returns are **received** from taxpayers.*" It is unclear if the author intended to implement a new continuous notification process to meet this requirement, which could be excessively burdensome to both the Controller and FTB, or if the existing process by which FTB regularly notifies the Controller of other, similar information would be sufficient.

The bill would require that FTB and the Controller be reimbursed for all costs incurred in connection with this fund if voters approve the adoption of the Act. However, no method of reimbursement is specified. Further, if the voters reject the Act on March 5, 2002, reimbursement would not provide for FTB costs incurred for placing the LEF on the return prior to the actual vote and processing those returns with check-offs.

The current tax forms are affected by serious space constraints. This bill would exacerbate the existing space constraints of the personal income tax forms by adding two or more additional lines to all individual tax returns and to instructional text. This addition could require the tax return to increase to three pages, which would greatly increase processing, programming, storage, and related costs.

Including this designation on all original personal income tax returns would be a significant change for all taxpayers. It has been the department's experience that when a tax law change impacts a significant number of taxpayers, taxpayer contact with the department increases. Accordingly, additional department resources are needed. However, since a similar designation is on the federal tax return, this change may not cause a substantial problem.

In addition to the other audits authorized by the PRA, during the 1997/1998 (two-year) election audit cycle, the department completed the FPPC designated audits. Because of the campaign contribution limits proposed by this bill, the complexity and length of Senate and Assembly audits would increase. Additionally, the number of candidates for mandatory audits is expected to increase since the public funding provisions may attract additional candidates. It is projected that the Senate audits would increase by six and the Assembly audits would increase by 40.

TECHNICAL CONSIDERATIONS

In Section 5 of this bill, Section 18900(c) specifies that language allowing designation to the LEF be placed on the **1999** tax return. However, Section 18900(a) specifies that the LEF designation would become operative for returns filed for taxable years beginning **2001**. The author may wish to change the year on which the language allowing designation to the LEF be placed on the return to the same year the LEF designation would be operative. With this change, the LEF designation would first appear on the 2001 tax return.

This designation is located in the Administration of Franchise and Income Tax Laws (Part 10.2 of the Revenue and Taxation Code). This bill defines "income tax liability" as the amount of taxes imposed on individuals minus certain credits under Part 10 (Personal Income Tax Law). The two references to "this part" in the definition of "income tax liability" should be changed to reference "Part 10."

This bill would define tax liability as the amount of taxes imposed, minus all the credits except the Renter's Credit, withholding credits, excess contributions tax credit, and estimated taxes. However, the renter's credit is now nonrefundable and should be subtracted like the other credits to determine tax liability. Further, the Household and Dependent Care Credit added in 2000 is refundable and should be disregarded as well.

This bill references two code sections that should be renumbered to reflect changes made in 1994. Specifically, Section "18551.1" (withholding credit) should be "19002" and Section "18557" (estimated taxes) should be "19007."

LEGISLATIVE HISTORY

SB 1169 (Bowen, 1999/2000) and **SB 2106** (Watson, 1997/1998) were essentially identical to this bill. SB 1169 failed to pass out of the house of origin by January 31st of the second year of the legislative session. SB 2106 remained in the Senate Revenue and Taxation Committee.

SB 1953 (Vasconcellos, 1997/1998) would have established the State Candidate Election Fund. This bill failed to pass out of the Senate Revenue and Taxation Committee.

SB 717 (Karnette, 1997/1998) would have reinstated and extended the operation of the California Election Campaign Fund to January 1, 2002. The Governor vetoed this bill on September 28, 1997, due to its "historical context and inclusion among charitable contributions." Contributions to this fund decreased annually and were not deductible as charitable contributions.

PROGRAM BACKGROUND

The California Election Campaign Fund (the first voluntary contribution fund) was enacted in 1982 and was first available for contribution on the 1982 tax return filed in 1983. Unlike this bill, which is a true checkoff of tax liability, the California Election Campaign Fund was created to allow a taxpayer to designate a portion of his or her tax refund to the fund. The fund sunsetted and was repealed by its own terms on January 1, 1997, and last appeared on the 1996 tax return. This fund received approximately \$95,532 from individual contributions on the 1996 tax returns.

Thirteen voluntary contribution funds appeared on the 2000 California personal income tax returns. Total contributions to these funds have varied from approximately \$3.4 million in 1989/1990 to approximately \$3.3 million in 1999/2000. The number of individuals contributing (first tabulated in 1993) remains fairly constant at approximately 140,000, or slightly less than 1% of all taxpayers.

OTHER STATES' INFORMATION

Of the states reviewed for their similarities to California state tax law (i.e., *Florida*, *Illinois*, *Massachusetts*, and *New York*), only *Massachusetts* allows individual contributions of \$1 of tax liability to be contributed to the Clean Elections Fund.

FISCAL IMPACT

Until implementation concerns are resolved, it is difficult to determine departmental costs. However, costs could be significant for processing, storage, and facilities. A rough estimate of approximately \$3.1 million and 20.3 personal years (PYs) for the first year costs and ongoing costs of \$2.0 million and 20 PYs has been projected.

ECONOMIC IMPACT

Tax Revenue Estimate

It is projected that redirection of taxes under the Personal Income Tax Law would be on the order of \$10 million annually.

This estimate is based on federal experience with the Presidential Election Campaign Fund where approximately 12% of all taxable returns in 1999 made designations of tax amounts to that Fund. It was assumed for this bill that, if authorized on the tax return, 15% of all taxable individual state returns would have the LEF designation beginning in 2002, i.e., approximately 680,000 joint filers would designate \$10 each and around 760,000 other filers would allocate \$5 each.

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